86-904 (1)

PETITION FOR WRIT OF CERTIORARI

No.

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1986

ROBERT B. TRAINER and
SIRIN D. TRAINER,

Petitioners,

v.

THE UNITED STATES,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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December 2, 1986

55 pp

QUESTION PRESENTED

Is the decision of the United States Court of Appeals for the Federal Circuit that the minimum tax imposed by section 56 of the Internal Revenue Code is an income tax, and not an excise tax, in conflict with the meaning of the term "income" as used in the sixteenth amendment to the United States Constitution and as defined by applicable decisions of this Court?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

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The petitioners, Robert B. and Sirin D. Trainer, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Federal Circuit entered in the above-entitled proceeding on September 5, 1986.

OPINIONS BELOW

The opinion of the Federal Circuit is reported at 800 F.2d 1086, and is reprinted in the appendix hereto at page 13a.

The opinion of the United States Claims Court is reported at 9 Cl. Ct. 211 (1985), and is reprinted in the appendix hereto at page 22a.

JURISDICTION

Invoking federal jurisdiction under section 1491, title 28 of the United States Code, petitioners brought this suit in the Claims Court. On December 5, 1985, the Claims Court granted respondent's Motion for Judgment on the Pleadings and dismissed petitioners' Complaint.

Petitioners appealed, and the Federal Circuit entered a judgment and an opinion on September 5, 1986, affirming the Claims Court. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the Federal Circuit is invoked under section 1254(1), title 28 of the United States Code.

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

United States Constitution Amendment XVI.

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

26 U.S.C. §§56, 57 and 58. The text of these provisions is reprinted in the appendix hereto at page 1a.

STATEMENT OF THE CASE

This case involves a suit for refund of income taxes by Robert B. and Sirin D. Trainer, appellants below and petitioners herein, for the taxable years ended December 31, 1974 and December 31, 1976 through December 31, 1980. For the taxable years ended December 31, 1976 through December 31, 1980, petitioners deducted amounts paid as minimum tax in each tax year as an ordinary and necessary business expense

under section 162 of the Internal Revenue Code (the "Code")[1] or as a necessary expense for the production of income or the management, conservation or maintenance of property held for the production of income under section 212 of the Code. Petitioners also paid, but failed to deduct, additional minimum tax in the taxable years ended December 31, 1976 and December 31, 1979.

The Commissioner of Internal Revenue (the "Commissioner") issued a notice of deficiency disallowing petitioners' deductions for the minimum tax. Petitioners paid the deficiencies and on February 3, 1984, timely filed claims for refund for the taxable years ended December 31, 1974 and December 31, 1976 through December 31, 1980. The refund claimed for 1974 resulted from the disallowance of the minimum tax as a deduction in 1977, which reduced the amount of the investment tax credit carried back to 1974. Pursuant to the provisions of section 1491, title 28 of the United States Code, petitioners filed a Complaint in the Claims Court on January 29, 1985, seeking a refund of federal income taxes for the above referenced years in the amount of $74,583.33, plus interest. *Robert B. Trainer and Sirin D. Trainer v. United States of America,* Civil Action No. 61-85 T. The Claims Court granted respondent's Motion for Judgment on the Pleadings and dismissed petitioners' Complaint by order issued on December 5, 1985. Petitioners filed an appeal on January 23, 1986, in the Federal Circuit. After oral argument, the Federal Circuit rendered a decision in favor of respondent on September 5, 1986, affirming the Claims Court's decision that the minimum tax was an income tax and not an excise tax.

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[1] Unless otherwise indicated, all section references and all references to the Internal Revenue Code or to the Code shall mean the Internal Revenue Code of 1954, as amended, as in effect for the years in issue.

Petitioners file this Petition for a Writ of Certiorari with this Court to appeal the decision of the Federal Circuit entered on September 5, 1986. Petitioners request that this Court review that decision for the reasons that the Federal Circuit has decided an important question of federal law which has not been, but should be, settled by this Court, and has decided a federal question in a way in conflict with applicable decisions of this Court.

REASONS FOR GRANTING THE WRIT

The decision of the Federal Circuit that the minimum tax is an income tax and not an excise tax establishes a definition of income that conflicts with decisions of this Court interpreting the meaning of the term "income" as used in the sixteenth amendment to the United States Constitution.

A. Introduction

The sixteenth amendment to the United States Constitution grants Congress the power to tax income without apportionment among the states. This Court has defined income for this purpose as realized gain, which excludes amounts that represent the recovery of capital costs. Although the minimum tax clearly is imposed on an amount that does not permit the full recovery of capital costs, the Federal Circuit held that the minimum tax under section 56 of the Code is imposed on income and is an income tax. Based on decisions of this Court defining the term "income" as used in the sixteenth amendment, a tax imposed on an amount that does not permit the recovery of capital costs cannot be an income tax, notwithstanding statutory language or congressional intent to the contrary.

The minimum tax is imposed on the privilege of utilizing certain provisions under the Code for the purpose of computing the income tax imposed by section 1 of the Code. Accordingly, it is an excise tax and, to the extent that the tax is attributable to

the taxpayer's trade or business or to the production of income, it is deductible in computing taxable income under sections 162 or 212 of the Code.[2]

B. The Minimum Tax Provisions

The minimum tax provisions of the Code at issue in this case, sections 56, 57 and 58, were enacted originally as part of the Tax Reform Act of 1969, Pub. L. No. 91-172, §301, 83 Stat. 487.[3] These provisions were amended during the taxable years in issue by the Tax Reform Act of 1976, Pub. L. No. 94-455, §301, 90 Stat. 1520, and the Revenue Act of 1978, Pub. L. No. 95-600, §421, 92 Stat. 2763.[4] For the taxable years in issue in this case, the minimum tax was computed by applying the minimum tax rate to the sum of the tax preference items less an exemption amount. The tax preference items were:

(1) Accelerated depreciation on personal property subject to a lease.

(2) Accelerated depreciation on real property.

(3) Accelerated deductions for intangible drilling and development costs.

(4) Accelerated amortization of certified pollution control facilities.

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[2] Treas. Reg. §1.164-2(f).

[3] Copies of §§56, 57 and 58, as they existed for taxable years beginning in 1976, are included in the Appendix hereto at page 1a.

[4] The Revenue Act of 1978, Pub. L. No. 95-600, §421, 92 Stat. 2763 (the "1978 Act"), removed capital gains and excess itemized deductions as preference items subject to the "add-on" minimum tax under §56 and made them subject to a new alternative minimum tax under §55 for taxable years beginning after 1978. The "add-on" minimum tax under §56 of the Code was repealed by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, §201, 96 Stat. 411 ("TEFRA"), and was replaced entirely by the "alternative minimum tax" under §55 of the Code.

(5) Accelerated amortization of railroad rolling stock.

(6) Accelerated amortization of on-the-job training and child care facilities.

(7) Reserve for losses on bad debts of financial institutions.

(8) The bargain element in a stock option.

(9) Percentage depletion deductions in excess of basis.

(10) The capital gain deduction.

(11) Excess itemized deductions.

I.R.C. §57(a).

C. The Characteristics of Income and of an Income Tax

The issue in this case is whether the minimum tax is imposed on income and thus is an income tax. The Federal Circuit held that the minimum tax is an income tax based on statutory language, congressional intent and prior cases considering the character of the minimum tax. The petitioners' position is that notwithstanding statutory language or congressional intent to the contrary, the minimum tax is not an income tax because it is not imposed on "income" as clearly defined for purposes of the sixteenth amendment by longstanding United States Supreme Court precedents.

The sixteenth amendment to the Constitution gives Congress the power to tax "incomes" without apportionment among the states. U.S. Const. amend. XVI. This Court has defined the term "income" as used in the sixteenth amendment to include only realized gain, and the concept of gain requires recovery of all capital costs. *Eisner v. Macomber,* 252 U.S. 189 (1920).

This Court consistently has held that income does not exist absent gain and that in order to have gain, amounts that represent a return of capital costs must be excluded. *Burnet v. Logan*, 283 U.S. 404 (1931); *United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931); *United States v. Ludey*, 274 U.S. 295 (1927); *Eisner v. Macomber, supra; Doyle v. Mitchell Bros.*, 247 U.S. 179 (1918); and *Southern Pacific Co. v. Lowe*, 247 U.S. 330 (1918). Other courts consistently have followed these fundamental principles. *Winkler v. United States*, 230 F.2d 766 (1st Cir. 1956); *Keasbey & Mattison Co. v. Rothensies*, 133 F.2d 894 (3d Cir.), *cert. denied*, 320 U.S. 739 (1943); *Davis v. United States*, 87 F.2d 323 (2d Cir.), *cert. denied*, 301 U.S. 704 (1937); *Bank of America Nat'l Trust & Savings Ass'n v. United States*, 459 F.2d 513, 517 (Ct. Cl.), *cert. denied*, 409 U.S. 949 (1972); *Allstate Insurance Co. v. United States*, 419 F.2d 409 (Ct. Cl. 1969); and *Ritter v. United States*, 393 F.2d 823 (Ct. Cl.), *cert. denied*, 393 U.S. 844 (1968). *See also* 1 J. Mertens, *The Law of Federal Income Taxation* §5.10 (J. Doheny rev. 1981).

Thus, under well-established, fundamental Constitutional principles, amounts received that represent the return of capital costs do not constitute income, as such term is defined for purposes of the sixteenth amendment, and a tax imposed on these amounts is not an income tax.

The Internal Revenue Service also has recognized these same characteristics for the existence of income. In connection with its pronouncements regarding whether a foreign tax qualifies for the foreign tax credit under section 901 of the Code against a taxpayer's United States federal income tax, the Service has enumerated the following characteristics of an income tax:

(1) The tax must be imposed on gain actually realized in the United States sense;

(2) The tax must be intended to reach net gain, and it must be so structured as to be almost certain of doing so; and

(3) The tax must be imposed on the receipt of income rather than on transactions such as the exercise of a privilege.

Rev. Rul. 78-61, 1978-1 C.B. 221. Moreover, Revenue Ruling 78-61 also notes that "a tax free recovery of invested capital has always been a characteristic of an income tax in the United States sense." 1978-1 C.B. at 225. Failure to meet any one of these requirements precludes classification of the tax as an income tax. *See also* Treas. Reg. §1.901-2(a)(3).

The definitional criteria applied to determine whether a foreign tax and a United States tax constitute an income tax are the same, and thus the Service's pronouncements in the foreign tax credit area are directly relevant. Nevertheless, the Federal Circuit rejected the criteria for an income tax set forth in Revenue Ruling 78-61 in determining whether the minimum tax is an income tax. Appendix, p. 20a. In rejecting Revenue Ruling 78-61, the court ignored the plain language of the ruling:

> Whether a foreign tax qualifies as an income tax within the meaning of section 901 of the Code depends on whether the tax constitutes an "income tax" *as determined from an examination of the Federal income tax laws of the United States.* [citations omitted]. Thus, the Courts have often said that a foreign tax will be considered to be an income tax within the meaning of section 901 only if that tax is *the substantial equivalent of the income tax in the United States sense.* [emphasis added]

Rev. Rul. 78-61, 1978-1 C.B. at 223. Further, the ruling sets forth the essential characteristics of a United States income tax. Clearly, the requirements listed in the ruling, and in section 1.901-2 of the regulations, are attributes of an income tax under United States federal concepts, and any tax purported to be an

income tax must be tested by these requirements. *See Keasbey & Mattison Co. v. Rothensies, supra.* Thus, the Federal Circuit erroneously repudiated the applicability of the criteria established by Revenue Ruling 78-61 in determining whether the minimum tax is an income tax.

In summary, the principles are clearly established that income is not present absent the full recovery of capital costs, and a tax imposed on capital costs cannot be an income tax. Congress cannot, by legislation, characterize such a tax as an income tax as its power to impose an income tax is derived from the sixteenth amendment to the Constitution. *See Eisner v. Macomber, supra* at 206; *Winkler v. United States, supra* at 770.

D. The Minimum Tax is Not Imposed on Income

The Federal Circuit's decision can stand only if the amount subject to the minimum tax constitutes income. Examination of the tax preference items and the structure of the minimum tax reveals, however, that the minimum tax is imposed, not on income, but primarily on capital costs.

The minimum tax is an indivisible tax because it is computed, not on each tax preference item separately, but on the sum of all of the tax preference items to the extent that such sum exceeds a specified minimum amount. Rev. Rul. 78-61, 1978-1 C.B. 221. If an indivisible tax is levied in part on items that do not constitute income and in part on items of income, it cannot be classified as an income tax. *Id.;* Rev. Rul. 74-435, 1974-2 C.B. 204; Rev. Rul. 59-208, 1959-1 C.B. 192, *as amplified by* Rev. Rul. 63-268, 1963-2 C.B. 290. Accordingly, even if some of the minimum tax preference items are income items, the minimum tax cannot be an income tax if the majority of the preference items are non-income items.

Seven of the eleven minimum tax preference items are methods of recovering capital costs.[5] The depreciation and

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[5] *See* the tax preference items (1) through (7) listed on pages 5-6, *supra.*

amortization preference items generally equal the excess of the deduction taken under an accelerated method of cost recovery authorized for income tax purposes over the deduction that would be allowed under a straight-line method. It is indisputable that depreciation deductions permit a taxpayer to recover its capital investment in wasting assets free of tax.[6] These deductions represent a charge against income for the exhaustion, wear and tear and obsolescence of capital assets during the tax year. *Detroit Edison Co. v. Commissioner,* 319 U.S. 98 (1943); *United States v. Ludey, supra; Cohn v. United States,* 259 F.2d 371 (6th Cir. 1958); and Treas. Reg. §1.167(a)-1.

Accelerated methods of depreciation do not increase the total amount of depreciation but merely alter the timing of the recovery of the capital costs. Whether a taxpayer uses straight-line or accelerated depreciation, the amount of the total deductions will be the same and will not exceed the capital cost of the property. Under an accelerated method of depreciation, the depreciation deduction in the earlier years will exceed the deduction that would be computed under the straight-line method. However, in later years, the deduction under the accelerated method will be less than the deduction computed under the straight-line method. The minimum tax is imposed

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[6] In all relevant respects, amortization is equivalent to depreciation. *See* Excess Profits Taxation, 1940, *Joint Hearings Before the House Comm. on Ways and Means and the Senate Comm. on Finance,* 76th Cong., 3d Sess. 21, 26 (1940); *Arkansas-Oklahoma Gas Co. v. Commissioner,* 201 F.2d 94 (8th Cir. 1953). Further, reserves for bad debts constitute reserves against the loss of capital. *See Saltstein v. Commissioner,* 46 B.T.A. 774, 777 (1942) (reserve is against loss of capital and does not differ materially from a reserve for depreciation). Accordingly, the depreciation, amortization and bad debt reserve preference items will not be analyzed separately; the analysis of the depreciation preference item will apply to all of these cost recovery preference items.

only to the extent that, and only in the years in which, the accelerated deduction exceeds the straight-line deduction. However, in the years in which the straight-line deduction exceeds the accelerated deduction, there is no reduction or adjustment made to the amount subject to the minimum tax. Thus, the minimum tax is imposed on capital costs.

For example, assume a taxpayer owns an asset with a cost basis of $100, accelerated depreciation deductions for income tax purposes are $40, $30, $15, $10 and $5 in years 1 through 5, respectively, and straight-line deductions are $20 per year for 5 years. The minimum tax will be imposed on $20 in year 1 and on $10 in year 2. In years 3, 4 and 5, when the straight-line deduction (or the minimum tax deduction) exceeds the accelerated deduction (or the income tax deduction) by $5, $10 and $15, respectively, there is no reduction to the amount subject to the minimum tax. Thus, the minimum tax is imposed on $30 of the cost of the asset, and the taxpayer does not recover all of this capital cost tax-free. Under the sixteenth amendment and decisions of this Court, an income tax may be imposed only upon income, which must allow for the full recovery of capital costs. Thus, the minimum tax is not an income tax.

Similarly, intangible drilling and development costs ("IDC") that are subject to the minimum tax are not recovered tax-free. Expenditures for IDC include amounts incurred by an operator of oil and gas properties for labor, fuel, repairs, hauling and supplies, incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas. Treas. Reg. §1.612-4. These expenditures for IDC are capital costs. *F.H.E. Oil Co. v. Commissioner,* 147 F.2d 1002 (5th Cir. 1945).

Section 263(c) of the Code authorizes a taxpayer to elect to deduct IDC expenditures in the year in which they are incurred, rather than to capitalize and recover the costs through depreciation or depletion. Treas. Reg. §§1.263(c)-1, 1.612-4. As in the case of accelerated depreciation, the election to deduct IDC does not increase the total amount of IDC deducted by the taxpayer, but alters only the timing of the IDC deductions. The IDC preference item exists only in the taxable year in which IDC are deducted under section 263(c). The minimum tax is imposed in that year on the total amount of IDC deducted less the amount that would have been deductible in that year if IDC had been capitalized and recovered under the straight-line method, generally over ten years. Since no adjustment is made to the amount subject to minimum tax in any of the nine subsequent years during which a deduction would have been taken under the straight-line method of depreciation, the minimum tax is imposed on this capital cost.

For example, assume that a taxpayer has gross receipts of $200 in year 1, that $100 of IDC is deducted under a section 263(c) election for income tax purposes and that $90 of the IDC is a tax preference item subject to the minimum tax. The minimum tax is imposed on $90 of IDC in that taxable year. In the remaining nine years, no reduction is made to the amount subject to the minimum tax for the $10 excess of the straight-line deduction in each of those years. Thus, $90 of IDC is not recovered tax-free because it is subject to the minimum tax.

In enacting the Tax Reform Act of 1986, Pub. L. No. 99-514, §§701-702 (the "1986 Act"), Congress addressed and partially remedied this aspect of the minimum tax in an apparent attempt to give the minimum tax the characteristics of an income tax. Congress recognized that the alternative minimum tax ("AMT"), the successor to the minimum tax, was not imposed on income with respect to the deferral-type preference items (*i.e.,* those that do not permanently exclude amounts from taxable income, such as depreciation) because

capital costs were not fully recovered for minimum tax purposes.[7] The Committee Reports state:

> The structure for the alternative minimum tax on individuals generally is the same under present law, except that adjustments are permitted in order to reflect the fact that certain deferral preferences (such as accelerated depreciation) cannot be treated simply as add-ons *if total income is to be computed properly over time.* For such preferences, the minimum tax deduction may in some instances exceed the regular tax deduction (e.g., in the later years of an asset's life), thus insuring that basis will be fully recovered under both the regular and the minimum tax systems. [emphasis added]

S. Rep. No. 99-313, 94th Cong., 2d Sess. (1986).

Under the 1986 Act, certain deferral preference items are eliminated, and in computing alternative minimum taxable income ("AMTI"), specified deductions are substituted for the income tax deductions. For example, AMTI is computed using a prescribed method of depreciation for AMT purposes for each year during which the asset is depreciated. For AMT purposes, personal property generally is depreciated on the straight-line method. I.R.C. §56(a)(1), as amended by the 1986 Act. Thus, if a taxpayer uses an accelerated method of depreciation

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[7] TEFRA repealed the §56 "add-on" minimum tax (which is the tax in issue in this case) and the alternative minimum tax as in effect before TEFRA (which was enacted by the 1978 Act), and enacted a new alternative minimum tax ("AMT"). The AMT is imposed only if it exceeds the income tax for the taxable year. The AMT is equal to the product of the AMT rate times alternative minimum taxable income ("AMTI"). Prior to the 1986 Act, AMTI generally was equal to adjusted gross income plus the tax preference items and less certain itemized deductions. As was the case with the add-on minimum tax, AMTI was not reduced in the years in which straight-line depreciation would exceed accelerated depreciation for the cost recovery preference items. Thus, despite this change in form, the AMT was not imposed on income because it continued to prohibit the full tax-free recovery of capital costs.

for income tax purposes, in some years the minimum tax deduction will exceed the income tax deduction, and AMTI will be less than taxable income by a corresponding amount, thereby insuring the tax-free recovery of the cost of the asset.[8] Further, if the asset is sold, gain will be computed for AMT purposes by using the basis of the asset reduced only by depreciation deducted in computing AMTI. I.R.C. §56(a)(7), as amended by the 1986 Act. Thus, the amount of gain on the sale included in AMTI and taxable income may differ. These changes indicate congressional recognition that the AMT, and implicitly its predecessor the add-on minimum tax, was not imposed on income and provide direct support for petitioners' position.

E. Prior Cases

The Federal Circuit relied on some of the various theories used by other courts to conclude that the minimum tax is an income tax, but none of these decisions satisfactorily confronted and refuted the fact that the minimum tax is imposed on capital costs. *See Mobley v. United States*, 8 Cl. Ct. 767 (1985); *Wyly v.*

[8] The 1986 Act also prescribes the method of recovering mining and exploration costs in computing AMTI, thus insuring the tax-free recovery of these costs. I.R.C. §56(a)(2), as amended by the 1986 Act. Mining and exploration costs were added as a preference item by TEFRA. Under 616 and 617 of the Code, a taxpayer may elect to treat expenditures for development and exploration of a mine as expenses currently deductible in the year in which paid or incurred rather than capitalize and amortize the amounts over the producing life of the mine. The preference item is the excess of the allowable deduction under §§616 and 617 over the amount that would have been allowable had the expenditure been capitalized and amortized on a straightline basis over a 10-year period. Congress, however, inexplicably did not change the IDC preference item, which is the corresponding deduction for oil and gas properties. Thus, the AMT continues to be imposed on this capital cost. *See* I.R.C. §57(a)(2), as amended by the 1986 Act.

United States, 662 F.2d 397 (5th Cir. 1981); *Graff v. Commissioner*, 74. T.C. 743 (1980), *aff'd*, 673 F.2d 784 (1982); *Stranahan v. Commissioner*, T.C. Memo 1982-151, Dec. 38,882(M), 43 T.C.M. (CCH) 883 (1982); *Ward v. United States*, 695 F.2d 1351 (10th Cir. 1982); *Standard Oil Co. (Indiana) v. Commissioner*, 77 T.C. 349 (1981). Not one of these cases contains a thorough analysis of the characteristics of income and the true nature of the preference items on which the minimum tax is imposed. Rather, these decisions have been based on one or more of the following theories:

1. Statutory language and congressional intent.

2. The minimum tax is in substance an adjustment to or a modification of the deduction.

3. The minimum tax is imposed on the taxpayer's "economic income".

4. The minimum tax is imposed on the economic benefit derived from the tax preferences.

As will be established, these theories do not support the conclusion that the minimum tax is imposed on income.

1. The Statutory Language and Congressional Intent.

The Federal Circuit (as well as other courts and the Internal Revenue Service) concluded that the minimum tax is imposed on income based in part on the location of the minimum tax in chapter 1 of Subtitle A of the Code, which is entitled "Income Taxes", and in part on legislative history indicating that Congress intended the minimum tax to be an income tax. Appendix, p. 14a; *Wyly v. United States, supra; Mobley v. United States, supra; Ward v. United States, supra; Lubus v. United States*, 78-1 U.S.T.C. ¶ 9242 (2d Cir.); and Rev. Rul. 77-396, 1977-2 C.B. 86. As has been established, a tax is an income tax only if it is imposed on income, as that term is defined for purposes of the sixteenth amendment by decisions

of this Court. Congress is powerless to impose an income tax on anything other than income.

Thus, neither congressional statements of intent to enact an income tax nor the inclusion of the tax in the income tax subtitle of the Code is sufficient to classify the minimum tax as an income tax. Unless the minimum tax is imposed on income in operation and effect, it is not an income tax.[9]

2. The "Adjustment" Theory.

Certain cases have argued that the minimum tax is imposed on income by reasoning that, in substance, the minimum tax is an adjustment to or a modification of the deduction for federal income tax purposes. Appendix, pp. 18a-19a; *Wyly v. United States, supra* at 405; *Graff v. Commissioner, supra* at 766-67. This "adjustment" argument ignores the operation and effect of the minimum tax.

The minimum tax does not operate as an adjustment to the income tax deduction because no adjustment is made to the basis of the property to reflect the imposition of the minimum tax on the preference item. For example, assume that a taxpayer owns depreciable property with an adjusted basis of $500. For the taxable year, the taxpayer takes accelerated depreciation on the property of $150, and the straight-line deduction would be $100. The tax preference item is $50. Under the "adjustment" theory, the taxpayer's depreciation deduction (*i.e.*, the amount that is recovered tax-free) for income tax purposes is reduced from $150 to $100. However,

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[9] The label placed on a tax does not relieve a court from its duty to make an independent determination of the true nature and effect of the tax. *Educational Films Corp. v. Ward*, 282 U.S. 379, 387 (1931); *Dawson v. Kentucky Distilleries & Warehouse Co.*, 255 U.S. 288 (1921); *Inland Steel Co. v. United States*, 677 F.2d 72 (Ct. Cl. 1982, adopting Trial Judge Report opinion per curiam).

the basis of the property does not reflect this "adjustment". The taxpayer's basis in the property is reduced by the full $150. Thus, if the property was sold for $500, gain of $150 would be subject to income tax, even though $50 already has been subject to minimum tax.

As discussed above, the 1986 Act has resolved this problem for the cost recovery preference items (except IDC) by providing for separate depreciation and basis adjustments for purposes of computing AMTI.[10]

3. A Tax on Economic Income.

Some courts have concluded that the minimum tax is imposed on income based on the theory that the minimum tax is imposed on "economic income". *Wyly v. United States, supra; Mobley v. United States, supra;* and *Graff v. Commissioner, supra.* None of these courts have defined the term "economic income". From the decisions, it can be inferred that "economic income" must mean taxable income computed by deducting and including only amounts that have "economic" significance. In the case of depreciation, this definition assumes that straight-line depreciation represents "economic" depreciation. As has been demonstrated, however, the computation of the minimum tax depreciation preference item does not permit the recovery of all capital costs.[11] Thus, the minimum tax is not imposed on the apparent definition of "economic income" or on an amount that is consistent with the definition of income as defined by this Court for purposes of the sixteenth amendment. Accordingly, the minimum tax is not imposed on income, "economic" or otherwise.

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[10] *See* text and accompanying footnotes at pp. 12-14, *supra.*

[11] *See* text at pp. 10-11, *supra.*

As discussed above, the 1986 Act has amended the minimum tax (or AMT) so that it will be imposed on an amount that more closely approximates income by providing for a reduction to AMTI in the years in which the minimum tax cost recovery deduction exceeds the income tax deduction (except in the case of IDC). Thus, under such Act, the AMT will not be imposed on capital costs (except IDC), but on the benefit derived from utilizing the preference items to defer income tax.[12]

4. A Tax on Economic Benefit.

Some courts have concluded that the minimum tax is an income tax because it is in substance imposed on the "economic benefit" derived by a taxpayer from the tax preference items. *Mobley v. United States, supra; Ward v. United States, supra;* and *Rhude v. United States,* 771 F.2d 1176 (8th Cir. 1985). This theory starts with the premise that any economic benefit constitutes income for federal income tax purposes. The courts then have reasoned that the tax preference items create an economic benefit, this economic benefit constitutes income for federal income tax purposes and the minimum tax is imposed on this amount; thus, the minimum tax is an income tax.

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[12]Respondent expressly acknowledged that tax deferral is the actual economic benefit produced by these tax preference items in its Brief for the Appellee in the United States Court of Appeals for the Federal Circuit, page 12, n.9:

> Moreover, it is not these [tax preference] deductions *per se* which are subject to the tax, but their timing, in the form of acceleration, instituted at taxpayers' election, which generate the taxable economic benefit.

This argument, however, undermines respondent's position because the add-on minimum tax in effect during the years in issue is not imposed on the value of the tax deferral but *on the total amount of the tax preference items.* Thus, the minimum tax is not imposed on income and is not an income tax.

The tax preference items permit a taxpayer to defer the payment of income tax, which creates an "economic benefit" to the taxpayer. Assuming, ***arguendo,*** that this "economic" benefit constitutes income, the fallacy in this theory is that the minimum tax is not imposed on such "economic benefit". The economic benefit would be equal to the reduction in or the deferral of the taxpayer's income tax. However, the minimum tax is imposed on the full amount of the tax preference items.[13]

For example, assume a taxpayer has $100 of gross receipts and is subject to a 40 percent tax rate. If this taxpayer has no deductions, his income subject to tax will be $100 and his tax liability will be $40. If this taxpayer has tax preference deductions of $100, his income subject to tax will be zero. The tax benefit to the taxpayer as a result of the tax preference item is equal to the tax savings of $40. However, the minimum tax is not imposed on this amount, but on the full amount of the tax preference item of $100.

Since the minimum tax is not imposed on the "economic benefit" to the taxpayer, it is not imposed on income and is not an income tax.

F. The Minimum Tax is a Deductible Excise Tax.

The minimum tax was enacted to insure that taxpayers who paid little or no income tax due to their use of the tax preference items would bear their share of the cost of government. Congress chose not to alter the income tax provisions applicable to the tax preference items. Rather, Congress chose to impose a tax directly on the privilege of enjoying the tax preferences that allowed these taxpayers to reduce substantially their income subject to the income tax. Accordingly, the

[13] *See* footnote 12, *supra.*

minimum tax is imposed not on income, but on the privilege of using and enjoying the tax preference items.[14]

An excise tax is defined as a tax imposed on an activity, the engaging in an occupation or the enjoyment of a privilege. *Waxenberg v. Commissioner,* 62 T.C. 594, 604 (1974); Rev. Rul. 84-169, 1984-2 C.B. 216. Revenue Ruling 84-169 considered whether the tax imposed under section 4940(a) of the Code is an excise tax or an income tax.[15] The ruling concluded that the tax is an excise tax because it is imposed on only a limited class of a foundation's income (net investment income) and based on legislative history that showed Congress intended the tax to be an excise tax.

In *Keasbey & Mattison Co. v. Rothensies, supra,* the third circuit court of appeals found that a foreign tax paid under the Quebec Mining Act was an excise tax. Although the tax was based in part on profits, the court determined that the subject of the tax was the mining privilege and that the tax base was the value of the output independent of realized gains or profits. The elements of the tax met the standards of an excise tax. A similar conclusion was reached with respect to a foreign tax imposed on a percentage of insurance premiums received. *St. Paul Fire & Marine Insurance Co. v. Reynolds,* 44 F. Supp. 863 (D. Minn. 1942). The court stated that an "excise tax may be levied on quantity, value or price, either wholesale or retail, or

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[14] In 1973, Secretary of the Treasury George Schultz, in reviewing the status of the minimum tax, stated:

> [The minimum tax] is not an income tax as such, but instead is a flat 10 percent surcharge on specified deductions excluded from income.

Schultz, *Nixon Administration Tax Reform Proposals Presented to House Ways and Means Committee* 18 (1973).

[15] Section 4940(a) of the Code imposes a tax equal to 2% of the net investment income for the taxable year of a private foundation that is exempt from taxation under §501(a).

it may be measured by income or a portion of income either net or gross." *Id.* at 366.

The windfall profit tax ("WPT") also constitutes an excise tax, which is deductible under section 164(a)(5) of the Code. The WPT is imposed on the crude oil produced in each taxable period. I.R.C. §4986. The tax base is a specified percentage of the excess of the removal price over the adjusted base price of each barrel of oil. I.R.C. §4987. However, the tax base cannot exceed 90 percent of the net income attributable to such barrel. The removal price is the sales price of the oil if sold when removed, or if removed prior to the sale, a constructive price. I.R.C. §4988. The adjusted base price represents an assumed value for oil in 1979. I.R.C. §4989. Clearly, the WPT is in substance an excise tax rather than an income tax. The subject of the tax is the production of oil, and the "windfall profit" does not constitute income. The "windfall profit" does not necessarily reflect the actual sales price of the oil or the cost of producing such oil.

The minimum tax is imposed on the privilege of utilizing certain provisions under the Code for the purpose of computing the income tax imposed by section 1 of the Code. The minimum tax was intended to reach only a specific class of taxpayers—those who enjoy this privilege. The tax base is composed of the tax preference items, independent of realized gains or profits. Accordingly, under established principles, the minimum tax is an excise tax and, to the extent incurred in connection with petitioners' trade or business or the production of income, is deductible under sections 162 or 212.

CONCLUSION

For these reasons, this petition for certiorari should be granted. If petitioners are correct in urging that the Federal Circuit's definition of income contradicts decisions of this Court, the decision below should be reversed and judgment ordered that petitioners are entitled to a refund of federal income taxes for the years in issue in the total amount of $74,583.33, or such greater sums as may be legally refundable, together with interest assessed thereon and paid, and together with the statutory interest on all amounts as provided by law. In the alternative, the decision below should be reversed and the case remanded to the Claims Court for a determination of whether the minimum tax was incurred by petitioners in connection with their trade or business or the production of income.

Respectfully submitted,

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December 2, 1986

APPENDIX

§ 56. Imposition of tax

(a) In general.—In addition to the other taxes imposed by this chapter, there is hereby imposed for each taxable year, with respect to the income of every person, a tax equal to 10 percent of the amount (if any) by which—

(1) the sum of the items of tax preference in excess of $30,000, is greater than

(2) the sum of—

(A) the taxes imposed by this chapter for the taxable year (computed without regard to this part and without regard to the taxes imposed by sections 72(m)(5)(B), 402(e), 408(f), 531 and 541) reduced by the sum of the credits allowable under—

(i) section 33 (relating to foreign tax credit),

(ii) section 37 (relating to retirement income),

(iii) section 38 (relating to investment credit),

(iv) section 40 (relating to expenses of work incentive program),

(v) section 41 (relating to contributions to candiates for public office,

(vi) section 42 (relating to credit for personal exemptions), and

(vii) section 44 (relating to credit for purchase of new principal residence); and

(B) the tax carry overs to the taxable year.

(b) Deferral of tax liability in case of certain net operating losses.—

(1) In general.—If for any taxable year a person—

(A) has a net operating loss any portion of which (under section 172) remains as a net operating loss carryover to a succeeding taxable year, and

(B) has items of tax preference in excess of $30,000,

then an amount equal to the lesser of the tax imposed by subsection (a) or 10 percent of the amount of the net operating loss carryover described in subparagraph (A) shall be treated as tax liability not imposed for the taxable year, but as imposed for the succeeding taxable year or years pursuant to paragraph (2).

(2) Year of liability.—In any taxable year in which any portion of the net operating loss carryover attributable to the excess described in paragraph (1)(B) reduces taxable income, the amount of tax liability described in paragraph (1) shall be treated as tax liability imposed in such taxable year in an amount equal to 10 percent of such reduction.

(3) Priority of application.—For purposes of paragraph (2), if any portion of the net operating loss carryover described in paragraph (1) (A) is not attributable to the excess described in paragraph (1)(B), such portion shall be considered as being applied in reducing taxable income before such other portion.

(c) Tax carry overs.—If for any taxable year—

(1) the taxes imposed by this chapter (computed without regard to this part and without regard to the taxes imposed by sections 72(m)(5)(B), 402(e), 408(f), 531 and 541) reduced by the sum of the credits allowable under—

(A) section 33 (relating to foreign tax credit),

(B) section 37 (Relating to retirement income),

(C) section 38 (relating to investment credit),

(D) section 40 (relating to expenses of work incentive program),

(E) section 41 (relating to contributions to candidates for public office),

(F) section 42 (relating to credit for personal exemptions), and

(G) section 44 (relating to credit for purchase of new principal residence), exceed

(2) the sum of the items of tax preference in excess of $30,000, then the excess of the taxes described in paragraph (1) over the sum described in paragraph (2) shall be a tax carry over to each of the 7 taxable years following such year. The entire amount of the excess for a taxable year shall be carried to the first of such 7 taxable years, and then to each of the other such taxable years to the extent that such excess is not used to reduce the amount subject to tax under subsection (a) for a prior taxable year to which excess may be carried.

§ 57. Items of tax preference

(a) In general—For purposes of this part, the items of tax preference are—

(1) Excess investment interest—The amount of the excess investment interest for the taxable year (as determined under subsection (b)).

(2) Accelerated depreciation on real property.—With respect to each section 1250 property (as defined in section 1250(c)), the amount by which the deduction allowable for the taxable year for exhaustion, wear and tear, obsolescence, or amortization exceeds the depreciation deduction which would have been allowable

for the taxable year had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life (determined without regard to section 167(k)) for which the taxpayer has held the property.

(3) Accelerated depreciation on personal property subject to a net lease.—With respect to each item of section 1245 property (as defined in section 1245(a)(3)) which is the subject of a net lease, the amount by which the deduction allowable for the taxable year for exhaustion, wear and tear, obsolescence, or amortization exceeds the depreciation deduction which would have been allowable for the taxable year had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life for which the taxpayer has held the property.

(4) Amortization of certified pollution control facilities.—With respect to each certified pollution control facility for which an election is in effect under section 169, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.

(5) Amortization of railroad rolling stock—With respect to each unit of railroad rolling stock for which an election is in effect under section 184, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.

(6) Stock options.—With respect to the transfer of a share of stock pursuant to the exercise of a qualified stock option (as defined in section 422(b)) or a restricted stock option (as defined in section 424(b)), the amount by which the fair market value of the share at the time of exercise exceeds the option price.

(7) Reserves for losses on bad debts of financial institutions.—In the case of a financial institution to which section 585 or 593 applies, the amount by which the deduction allowable for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

(8) Depletion.—With respect to each property (as defined in section 614), the excess of the deduction for depletion allowable under section 611 for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year).

(9) Capital gains.—

(A) Individuals.—In the case of a taxpayer other than a corporation, an amount equal to one-half of the amount by which the net long-term capital gain exceeds the net short-term capital loss for the taxable year.

(B) Corporations.—In the case of a corporation, if the net long-term capital gain exceeds the net short-term capital loss for the taxable year, an amount equal to the product obtained by multiplying such excess by a fraction the numerator of which is the sum of the normal tax rate and the surtax rate under section 11, minus the alternative tax rate under section 1201(a), for the taxable year, and the denominator of which is the sum of the normal tax rate and the surtax rate under section 11 for the taxable year. In the case of a corporation to which section 1201(a) does not apply, the amount under this subparagraph shall be determined under regulations prescribed by the Secretary or his delegate in a manner consistent with the preceding sentence.

(10) Amortization of on-the-job training and child care facilities.—With respect to each item of section 188 property for which an election is in effect under section 188, the amount by which the deduction allowable for the taxable year under such section exceeds the depreciation deduction which would otherwise be allowable under section 167.

Paragraph (1) shall apply only to taxable years beginning before January 1, 1972. Paragraphs (1) and (3) shall not apply to a corporation other than an electing small business corporation (as defined in section 1371(b)) and a personal holding company (as defined in section 542).

§ 58. Rules for application of this part

(a) Husband and wife.—In the case of a husband or wife who files a separate return for the taxable year, the $30,000 amount specified in section 56 shall be $15,000.

(b) Members of controlled groups.—In the case of a controlled group of corporations (as defined in section 1563(a)), the $30,000 amount specified in section 56 shall be divided equally among the component members of such group unless all component members consent (at such time and in such manner as the Secretary or his delegate prescribes by regulations) to an apportionment plan providing for an unequal allocation of such amount.

(c) Estates and trusts.—In the case of an estate or trust—

(1) the sum of the items of tax preference for any taxable year of the estate or trust shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each, and

(2) the $30,000 amount specified in section 56 applicable to such estate or trust shall be reduced to an amount

which bears the same ratio to $30,000 as the portion of the sum of the items of tax preference allocated to the estate or trust under paragraph (1) bears to such sum.

(d) Electing small business corporations and their shareholders.—

(1) In general.—Except as provided in paragraph (2), the items of tax preference of an electing small business corporation (as defined in section 1371(b)) for each taxable year of the corporation shall be treated as items of tax preference of the shareholders of such corporation, and, except as provided in paragraph (2), shall not be treated as items of tax preference of such corporation. The sum of the items so treated shall be apportioned pro rata among such shareholders in a manner consistent with section 1374(c) (1). For purposes of this paragraph, this part shall be treated as applying to such corporation.

(2) Certain capital gains.—If for a taxable year of an electing small business corporation a tax is imposed on the income of such corporation under section 1378, such corporation shall, notwithstanding the provisions of section 1371(b) (1), be subject to the tax imposed by section 56, but computed only with reference to the item of tax preference set forth in section 57(a) (9) (B) to the extent attributable to gains subject to the tax imposed by section 1378.

(e) Participants in a common trust fund.—The items of tax preference of a common trust fund (as defined in section 584(a)) for each taxable year of the fund shall be treated as items of tax preference of the participants of such fund and shall be apportioned pro rata among such participants. For purposes of this subsection, this part shall be treated as applying to such fund.

(f) Regulated investment companies, etc.—In the case of a regulated investment company to which part I of subchapter M applies or a real estate investment trust to which part II of subchapter M applies—

(1) the item of tax preference set forth in section 57(a) (9) shall not be treated as an item of tax preference of such company or such trust for each taxable year to the extent that such item is attributable to amounts taken into account as income by the shareholders of such company under section 852(b) (3), or by the shareholders or holders of beneficial interests of such trust under section 857(b) (3), and

(2) the items of tax preference of such company or such trust for each taxable year (other than the item of tax preference set forth in section 57(a) (9) and, in the case of a real estate investment trust, the item of tax preference set forth in section 57(a) (2)) shall be treated as items of tax preference of the shareholders of such company, or the shareholders or holders of beneficial interests of such trust (and not as items of tax preference of such company or such trust), in the same proportion that the dividends (other than capital gain dividends) paid to each such shareholder, or holder of beneficial interest, bears to the taxable income of such company or such trust determined without regard to the deduction for dividends paid.

(g) Tax preferences attributable to foreign sources.—

(1) In general.—For purposes of section 56, the items of tax preference set forth in section 57(a) (other than in paragraphs (6) and (9) of such section) which are attributable to sources within any foreign country or possession of the United States shall be taken into account only to the extent that such items reduce the tax imposed by this chapter (other than the tax imposed by section 56) on income derived from sources within the United States. For purposes of the preceding

sentence, items of tax preference shall be treated as reducing the tax imposed by this chapter before items which are not items of tax preference.

(2) **Capital gains and stock options.**—For purposes of section 56, the items of tax preference set forth in paragraphs (6) and (9) of section 57(a) which are attributable to sources within any foreign country or possession of the United States shall not be taken into account if, under the tax laws of such country or possession—

(A) in the case of the item set forth in paragraph (6) of section 57(a), preferential treatment is not accorded transfers of shares of stock pursuant to stock options described in such paragraph, and

(B) in the case of the item set forth in paragaph (9) of section 57(a), preferential treatment is not accorded gain from the sale or exchange of capital assets (or property treated as capital assets).

For purposes of this paragraph, preferential treatment is accorded such items which are attributable to a foreign country or possession of the United States if such country or possession imposes no significant amount of tax with respect to such items.

(b) **Excess investment interest.**—

(1) **In general.**—For purposes of paragraph (1) of subsection (a), the excess investment interest for any taxable year is the amount by which the investment interest expense for the taxable year exceeds the sum of—

(A) the net investment income for the taxable year, and

(B) the amount (if any) by which the deductions allowable under sections 162, 163, 164(a) (1) or (2), and 212 attributable to property of the taxpayer subject to a net lease exceeds the gross rental income produced by such property for the taxable year.

(2) **Definitions.**—For purposes of this subsection—

(A) **Net investment income.**—The term "net investment income" means the excess of investment income over investment expenses.

(B) **Investment income.**—The term "investment income" means—

(i) the gross income from interest, dividends, rents, and royalties,

(ii) the net short-term capital gain attributable to the disposition of property held for investment, and

(iii) amounts treated under sections 1245 and 1250 as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231,

but only to the extent such income, gain, and amounts are not derived from the conduct of a trade or business.

(C) **Investment expenses.**—The term "investment expenses" means the deductions allowable under section 162, 164(a) (1) or (2), 166, 167, 171, 212, 243, 244, 245, or 611 directly connected with the production of investment income. For purposes of this subparagraph, the deduction allowable under section 167 with respect to any property may be treated as the amount which would have been allowable had the taxpayer depreciated the property under the straight line method for each taxable year of its useful life for which the taxpayer has held the property, and the deduction allowable under section 611 with respect to any property may be treated as the amount which would have been allowable had the

taxpayer determined the deduction under section 611 without regard to section 613 for each taxable year for which the taxpayer has held the property.

(D) Investment interest expense.—The term "investment interest expense" means interest paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment. For purposes of the preceding sentence, interest paid or accrued on indebtedness incurred or continued in the construction of property to be used in a trade or business shall not be treated as an investment interest expense.

(3) Property subject to net lease.—For purposes of this subsection, property which is subject to a net lease entered into after October 9, 1969, shall be treated as property held for investment, and not as property used in a trade or business.

(c) Net leases.—

(1) In general.—For purposes of this section, property shall be considered to be subject to a net lease for a taxable year if—

(A) for such taxable year the sum of the deductions of the lessor with respect to such property which are allowable solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) is less than 15 percent of the rental income produced by such property, or

(B) the lessor is either guaranteed a specified return or is guaranteed in whole or in part against loss of income.

(2) Multiple leases of single parcel of real property.—If a parcel of real property of the taxpayer is leased under two or more leases, paragraph (1)(A) shall, at the

election of the taxpayer, be applied by treating all leased portions of such property as subject to a single lease.

(3) Elimination of 15-percent test after 5 years in case of real property.—At the election of the taxpayer, paragraph (1)(A) shall not apply with respect to real property of the taxpayer which has been in use for more than 5 years.

(4) Elections.—An election under paragraph (2) or (3) shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

ROBERT B. TRAINER and SIRIN D. TRAINER,
Appellants,
v.
THE UNITED STATES,
Appellee.

Appeal No. 86-850.

DECIDED: September 5, 1986

Before NIES, *Circuit Judge,* MILLER, *Senior Circuit Judge,* and BISSELL, *Circuit Judge.*

MILLER, *Senior Circuit Judge.*

This appeal in a tax refund suit[1] is from the judgment of the United States Claims Court dismissing appellants' complaint based on the United States' ("Government") motion for judgment on the pleadings.[2] We affirm.

The issue is whether the Claims Court's order was erroneous, being based on its holding in *O.B. Mobley, Jr. v. United States,* 8 Cl. Ct. 767 (1985), that the minimum tax is an income tax and the clear implication that, therefore, it is not an excise tax deductible under section 162 (trade or business expenses) or section 212 (expenses for production of income) of the

[1] Appellants claim that they are entitled to a refund of taxes totaling $74,583.33 for the years 1974 and 1976 through 1980 plus interest thereon paid in the amount of $21,126.12 plus statutory interest.

[2] The case is reported at 9 Cl. Ct. 211 (1985).

Internal Revenue Code as argued by appellants.[3] In its order, 9 Cl. Ct. at 213, the Claims Court stated:

> In a word, plaintiff [Trainer] wishes to retry *Mobley* even though there is admittedly no factual distinction between [*Mobley*] and *Trainer.* This court feels strongly that the decision in *Mobley* is correct and binding upon *Trainer.* Moreover, the holding in *Mobley,* as a matter of *stare decisis,* has precedential value vis-a-vis *Trainer.*

The court's position on the binding effect of *Mobley* rested on the circumstances that *Trainer* and *Mobley* were concurrent cases before the same judge with no factual differences of consequence and that Trainer elected to not consolidate with *Mobley.*

Section 56(a) of the Internal Revenue Code (26 U.S.C. §56(a)), by appellants and the Government as applicable to the taxable years involved, provides (emphasis supplied) that—

> there is hereby imposed for each taxable year, *with respect to the income* of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—
>
> (1) $10,000, or
> (2) the regular tax deduction for the taxable year . . . .

The statute also provides that the tax is—

> [in] addition to the other taxes imposed by this chapter.

The chapter referred to is Chapter 1, which is a part of Subtitle A of the Internal Revenue Code entitled "Income Taxes." Excise taxes are provided for in Subtitles D and E. Appellants argue that this language is ambiguous because of use of the

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[3] In *Mobley,* the Claims Court stated that it did not reach the taxpayers' argument that the minimum tax is an excise tax deductible under sections 162 or 212 of the Internal Revenue Code. 8 Cl. Ct. at 773.

phrase "with respect to the income" rather than the phrase "on the income." Indeed, they seek to rewrite the statute to read "with respect to the enjoyment of tax preferences" in order to support their argument that the minimum tax is an excise tax.

Assuming, arguendo, that there is an ambiguity, the legislative history demonstrates the Congressional intent that the minimum tax be imposed on income. Thus, the House Report accompanying the bill that became the Tax Reform Act of 1969 states that

> an individual is to be allowed to claim the exclusions and deductions comprising *tax preference income* only to the extent that the aggregate amount of these preferences does not exceed one-half of his total *income.*

(Emphasis supplied.) H.R. Rep. No. 413 (Pt. 1), 91st Cong., 1st Sess. 79 (1969), 1969-3 C.B. 200, 249. The House Report continues:

> The application of the limit on tax preferences may be illustrated by the case of a taxpayer with $50,000 of salary and $150,000 of tax preference amounts. Under present law, such an individual is taxed only on his $50,000 of salary. Under the limit on tax preferences, he is to be required to pay tax on $100,000 of *income* (one-half his total *income* of $200,000).
>
> * * * *
>
> *Revenue effect.*—It is estimated that the limit on tax preferences will increase tax liability by $40 million in the calendar year 1970 and by $85 million a year when the provision is fully effective.

Id. at 79-80. (Emphasis supplied.)

Senate Rep. No. 552, 91st Cong., 1st Sess. 111-12 (1969), 1969-3 C.B. 423, 495, refers to "economic income" from various tax preferences. In commenting on the House provisions for a limit on tax preferences, the Senate Report states that these "do not lend themselves to the taxation of preferences enjoyed by corporations" and points out that—

> a corporation with sufficient tax preferences ... could arrange to escape from their impact by merging with other corporations with relatively small amounts of *tax preference income.*

(Emphasis supplied.) *Id.* at 113. The merger technique would not be relevant if the minimum tax were an excise tax.

The Senate Report continues:

> *Revenue Effect.*—It is estimated that the 5-percent minimum tax will increase revenue by an estimated $650 million in 1970 and $700 million in the long run.

Id. at 118.

Conference Rep. No. 782, 91st Cong., 1st Sess. 301-02 (1969), 1969-3 C.B. 644, 658-59, states:

> The House bill requires individuals with substantial amounts of otherwise *tax-free income* to pay significant amounts of tax through the use of two basic provisions: a limit on tax preferences which requires the individual taxpayer to aggregate his taxable income and his tax-free income and to include at least one-half of this amount in his tax base ....
>
> The Senate amendment substitute for the two House provisions provides a minimum tax on *preference income* .... Under the Senate amendment *tax preference income,* after the deduction of a $30,000 exemption, and after the deduction of the taxpayer's regular Federal income tax, is taxed at a 10-percent rate.

(Emphasis supplied.) The Conference Report states that the Conference substitute "follows the Senate amendment" with certain adjustments not pertinent to this case.

We agree with appellants that the classification of a tax must be determined by its operation and effect (substance) rather than descriptive language used by Congress (form). However, appellants' problem[4] is that they ignore the economic

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[4] Also that of *amicus curiae* Atlantic Richfield Company.

reality (substance) of tax preferences and the reduction of the income tax deduction for those preferences by application of the minimum tax. For example, appellants criticize the economic income theory as applied to the excess of accelerated depreciation over straight-line depreciation without considering the savings in interest that would otherwise be incurred on borrowed capital. The Senate Report accompanying the Tax Reform Act of 1976 referred to the benefit of tax deferral as "equivalent to an interest-free loan from the Federal Government." Senate Rep. No. 938, 94th Cong., 2d Sess. 109 (1976). Nowhere in the reports of the House, the Senate, or the Conference is there any indication whatsoever that the estimates of revenue from the minimum tax are calculated by subtracting the minimum tax as an excise tax. Indeed, such a result would obviously frustrate the intent of Congress to "reduce drastically the ability of individuals to escape payment of tax on economic income."[5] H. Rep. No. 413 (Pt. 1), 91st Cong., 1st Sess. 78.

Appellants criticize cases cited by the Government for not meeting various points made in their arguments here. Of course, without the briefs and transcribed oral arguments in those cases, we do not know whether those points were made. If they were, the failure of the courts to respond to them does not mean they were not considered. If they were not, it does not follow that the cases are without precedential value.

In addition to *Mobley v. United States, supra,* these cases include, *inter alia: Wyly v. United States,* 662 F.2d 397, 405 (5th Cir. 1981), which held that the minimum tax is a tax on income and is therefore constitutional, citing *Graff v. Commissioner,* 74 T.C. 743, 766-67 (1980), *aff'd,* 673 F.2d 784 (5th Cir. 1982). There the Tax Court cited *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, *reh'g denied,* 349 U.S. 925

[5] If the minimum tax were deductible as an excise tax, a taxpayer in the fifty percent income tax bracket could effectively halve the impact of the minimum tax.

(1955), for the statement that "income may include virtually any economic benefit received by the taxpayer," 74 T.C. at 766, and concluded that the tax preference deduction for long term capital gains "is modified in the case of a taxpayer subject to the minimum tax," and tax deductions for accelerated depreciation "are readjusted."[6]

Id. In *Ward v. United States,* 695 F.2d 1351, 1355 (10th Cir. 1982), the court held that the minimum tax on intangible drilling and development costs is an income tax, quoting from *Wyly.* In *Lubus v. United States,* 78-1 U.S.T.C. ¶9242, 48 A.F.T.R.2d 81-5760 (2d Cir. 1978), affirming an unreported 1977 decision of the District Court for Connecticut, the court stated that section 56 of the Internal Revenue Code "imposes a tax '[i]n addition to the other taxes' imposed under the income tax provisions," and that "Congress's intention was ... to impose an additional tax upon high-income individuals with large amounts of nonwage income." 78-1 U.S.T.C. at ¶9243; 48 A.F.T.R.2d at 5760. *See Kolom v. Commissioner,* 644 F.2d

[6] Thus, it is the deduction for total tax preferences that is modified or readjusted by the minimum tax—not the tax preference items themselves. Appellants point to 26 U.S.C. §58(h), which was added to the Code in the Tax Reform Act of 1976, to support their contention that economic benefit is the reduction in a taxpayer's income *tax*—not the reduction in his *income.* Section 58(h) requires the Treasury Secretary to prescribe regulations "under which items of tax preference shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's tax under this subtitle ...." However, we are not persuaded that adoption of the tax benefit rule evidences any Congressional intent to change the economic income theory of the minimum tax. Senate Rep. 938, *supra,* states that the "minimum tax on tax preferences was enacted in 1969 in order to ensure that high-income individuals ... pay at least a minimum rate of tax on their preferences ...." *See also* H.R. Rep. No. 658, 94th Cong., 1st Sess. 130 (1975). Appellants' arguments that Congress never intended the minimum tax to be an adjustment to the basis of tax preference items is inapt.

1282 (9th Cir.), *cert. denied,* 454 U.S. 1011 (1981), holding that the "bargain element" upon exercise of a stock option) subject to the minimum tax is the difference between the mean price on the New York Stock Exchange on the date of exercise of the stock option and the option price; further, that the taxpayer's unwillingness to sell his stock on the date of exercise of the stock option is "irrelevant" to the determination of fair market value. *Id.* at 1288. In *Mobley,* the Claims Court's holding related to the tax preferences for intangible drilling and development costs and percentage depletion. The court well summarized its position, with which we agree, that it could not

> ignore the plain language of the statute, the intent of Congress as revealed in the legislative history, and the holdings of other courts.

8 Cl. Ct. at 769.

To support their argument that the minimum tax is an excise tax, appellants beg the question by stating:

> Congress chose to impose a tax directly on the privilege of enjoying the tax preferences that allowed . . . taxpayers to avoid the payment of income tax. Accordingly, the minimum tax is imposed on the privilege of using and enjoying the tax preference items.

As a matter of substance, however, the minimum tax reduces the income tax deduction for tax preferences. For simplicity, the total of tax preferences serves as the tax base. Appellants argue that Congress *could have* provided for adjustments to the individual tax preferences. But Congress did not do so, and the obvious complexity of such an approach compared to simply computing the minimum tax by applying the rate to the sum of tax preferences is a sufficient reason.[7]

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[7] Appellants cite Rev. Rul. 84-169, 1984-2 C.B. 216, which concludes that Congress intended the tax under section 4940(a), I.R.C., to be an excise tax on investment activity of a tax-exempt private foundation. However, the legislative history cited by the Ruling, unlike that cited earlier in this opinion, evidences Congres-

The Government cites the Supreme Court's opinion in *United States v. Darusmont*, 449 U.S. 292 (1981), "where the Court repeatedly referred to the minimum tax as a 'federal income tax'." Although the holding of the Court was that amendments to the minimum tax provisions could be applied retroactively to the entire calendar year (1976) in which enactment took place without violating the Due Process Clause of the Fifth Amendment, so that, as appellants argue, the Court's references constitute dicta, the dicta are particularly strong. For example, the Court in the *first line* of its opinion refers to the case as a "federal income tax refund suit."[8] Elsewhere, the Court refers to "the portion of appellee's 1976 income tax liability attributable to the minimum tax imposed by §56 the Code on items of tax preference as defined in §57." 449 U.S. at 294. Were this a "close" case, which we do not believe is so, the Court's dicta would carry the day.

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sional intent to impose an *excise* tax. Appellants further cite Rev. Rul. 78-61, 1978-1 C.B. 221, and 26 C.F.R. §1.901-2 relating to the credit allowed for income tax paid to a foreign country and complain that the Government has refused to analyze the minimum tax under the criteria set forth therein for determining whether a foreign tax is an income tax. One of the criteria is that the predominant character of the foreign tax is "that of an income tax in the U.S. sense." 26 C.F.R. §1.901-2(a)(1)(ii). This turns on whether the gain on which the foreign tax is levied is "realized in the United States sense." Rev. Rul. 78-61 states, however, that the United States income tax "does tax in certain limited situations the constructive or deemed receipt of income." *Id.* at 223. That, of course, is what the minimum tax does, as a matter of substance. In any event, Rev. Rul. 78-61 is not binding on this court; and, although Treasury Regulations are of greater force and effect than Revenue Rulings, 26 C.F.R. §1.901-2 was not issued until after the years involved here (T.D. 7918, Oct. 6, 1983, 1983-2 C.B. 113). Of greater relevance is 26 C.F.R. §1.56-1(a) (1978), which states: "Selection 56(a) imposes an income tax on the items of tax preference.... The items of tax preference represent income...."

[8] We note that in their STATEMENT OF THE CASE appellants, similarly to the Supreme Court in *Darusmont,* recite that this case "involves a suit for refund of income taxes."

In view of the foregoing, we hold that the minimum tax is an income tax and not an excise tax deductible under sections 162 or 212 of the Internal Revenue Code.

Accordingly, the Claims Court's order was not erroneous and is *affirmed*.

AFFIRMED

IN THE UNITED STATES CLAIMS COURT

(FILED: December 5, 1985)

No. 61-85T

ROBERT B. TRAINER AND SIRIN D. TRAINER, *Plaintiff*, *v.* THE UNITED STATES, *Defendant*.	Motion for judgment on the pleadings allowed; RUSCC 12(c); 56(a) and (d); *stare decisis;* failure to consolidate similar cases.

Buford P. Berry, Dallas, Texas, for plaintiff.

W. C. Rapp, Washington, D.C., with whom was *Assistant Attorney General Glenn L. Archer, Jr.*, for defendant.

ORDER

TIDWELL, Judge.

The cases of *O.B. Mobley, Jr., etc. v. United States*, No. 620-81T and *Michael Stranahan v. United States*, No. 322-82T, were consolidated on October 5, 1982, because they called for the determination of substantially identical issues.[1] Pursuant to RUSCC 77(f)(2), counsel for defendant in *Robert B. Trainer and Sirin D. Trainer v. United States*, No. 61-85T notified the court that the issue in *Trainer* appeared to be the same issue in *Mobley*, thereby indicating that consideration should be given to consolidating the three cases.

[1] Because these two cases were consolidated and only one Opinion issued disposing of both, the court hereafter references both by citing to *Mobley*.

Trainer was reassigned to Judge Tidwell who ordered counsel in the three cases to contact each other to discuss the possibility of consolidation. Thereafter, on August 9, 1985, a telephone conference was held by the court with counsel in the three cases to discuss consolidation of *Trainer* with *Mobley*. There was consensus that the factual background of the three cases were similar but that *Trainer* was substantially behind *Mobley* in the pretrial process. Counsels for *Mobley* argued against consolidation with *Trainer* because *Trainer* was a relatively "new" case that had been filed in January of 1985 and would most likely not be ready for trial for many months.[2] The court agreed with counsels for plaintiffs that it would be manifestly unfair to postpone oral arguments until *Trainer* would be prepared to participate. Thereafter, counsel for defendant in *Trainer* filed a motion for suspension of proceedings pending outcome of *Mobley*.

The court denied the latter motion and four days later issued an Opinion in *Mobley* holding that the minimum tax imposed by section 56 of the Internal Revenue Code is a non-deductible income tax and not a deductible excise tax. Thereafter, on October 11, 1985, defendant filed a Motion for Judgment on the Pleadings pursuant to RUSCC 12(c) which states:

> *Motion for Judgment on the Pleadings.* After the pleadings are closed, but within such time as not to delay the trial, any party may move for judgment on the pleadings. If, on a motion for judgment on the pleadings, matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

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[2] *Mobley* had been filed in 1981 and *Stranahan* in 1982.

Plaintiff in this case filed its Complaint on January 29, 1985; defendant answered on May 29, 1985. The pleadings are closed and the court finds them to be comprehensive of plaintiff's and defendant's legal and factual positions. The court has carefully studied defendant's Notice of Related Cases of June 28, 1985, defendant's Motion for Judgment on the Pleadings of October 11, 1985, plaintiff's Objection to defendant's Motion for Judgment on the Pleadings of November 12, 1985 and plaintiff's Motion (1) requesting an Order denying defendant's Motion for Judgment on the Pleadings and (2) for leave to file a Motion for Summary Judgment, and the Reply of defendant in Support of its Motion for Judgment on the Pleadings, of November 18, 1985. The court is satisfied that plaintiff put forward no matters outside of the pleadings and that accordingly, the court may properly consider Defendant's Motion for Judgment on the Pleadings without treating it as a Motion for Summary Judgment. RUSCC 12(c).

Following Defendant's Motion for Judgment on the Pleadings, plaintiff filed its Objection and defendant replied thereto. Trainer's Objection to defendant's Motion for Judgment on the Pleadings acknowledged that their case is "probably" covered by the court's decision in *Mobley;* however, *Trainer* disagrees with the decision of the United States Claims Court and wishes to take *Trainer* on appeal to the United States Court of Appeals for the Federal Circuit. This court has no objection to an appeal of the issue and, in fact, encourages it in order to interpret the law, at least within this one relatively small area of the law.

Unfortunately, *Trainer* elected not to consolidate with *Mobley* and now desires an opportunity, which it may have in any event, to bring its case to the United States Court of Appeals for the Federal Circuit by requesting more expansive proceedings before this court. In a word, plaintiff wishes to retry *Mobley* even though there is admittedly no factual distinction between those cases and *Trainer.* This court feels strongly that the decision in *Mobley* is correct and binding upon

Trainer. Moreover, the holding in *Mobley,* as a matter of *stare decisis,* has precedential value vis-a-vis *Trainer.* The issue in *Trainer* has been adequately addressed and answered. In plaintiff's request to file a Motion for Summary Judgment, counsel states that the issues are the same as in *Mobley* and that "plaintiffs anticipate that the court may not rule in their favor." *Trainer* merely wishes an opportunity to persuade the court that it ruled incorrectly in *Mobley* and, if it does not prevail to place itself into a proper posture for appeal.

Trainer simultaneously filed a "Motion" requesting the court to deny Defendant's Motion for Summary Judgment and to grant *Trainer* permission to file a Motion for Summary Judgment within 30 days of the court's "favorable" order. *Trainer's* reasons therefor are the same as cited in its Objection to Defendant's Motion for Judgment on the Pleadings, and need not be repeated at length here.

It is a truism that plaintiff could have filed a Motion for Summary Judgment. See RUSCC 56(a), 12(c). However, even if, *arguendo,* plaintiff filed a Motion for Summary Judgment, it could not prevail, as proved by plaintiff's own pleadings. It is Motion and in its Objection to Defendant's Motion for Judgment on the Pleadings, plaintiff acknowledges "that there (sic) case is covered by the Court's decision in *Mobley and Stranahan* (sic) because there is no significant factual distinction between those cases and their case." Defendant agrees. That being the case plaintiff met the basic criteria for summary judgment disposition in that there are admittedly no facts of genuine issue to litigate. *See* RUSCC 56(d). Following the circuit of logical consequences, however, leads plaintiff back to the impenetrable jungle, *i.e., Mobley.* There are no facts of genuine issue or differences of consequence between *Trainer* and *Mobley* and, contrary to plaintiff's deepest wishes, the law, as personified in the latter opinion, and long list of supporting cases cited therein, would lead quickly to a judgment identical to *Mobley,* to wit:

> Faced with the plain language of the statute, its legislative history, and the holdings of [this and] other courts, we hold that the minimum tax is an income tax . . . .

Mobley, at 6.

Plaintiff has failed to show any significant reason why its case should be litigated further. Accordingly, defendant's Motion for Judgment on the Pleadings is granted, plaintiff's Motion for an Order Denying Defendant's Motion for Judgment on the Pleadings is denied as is plaintiff's Objection to defendant's Motion for Judgment on the Pleadings.[3] The Clerk is directed to dismiss the Complaint.

IT IS SO ORDERED.

MOODY R. TIDWELL

Moody R. Tidwell
Judge

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[3] Plaintiff, it will be recalled, requested permission of the court to file a Motion for Summary Judgment. In view of this Order the issue is moot and need not be addressed.